

MEMORANDUM

March 20, 2012

To: File on Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank Act**”)

From: Michael J. Spratt
Office of Investment Adviser Regulation
Division of Investment Management

Re: Meeting with Occupy the SEC

On March 20, 2012, representatives of Occupy the SEC participated in a meeting with Securities and Exchange Commission (“**SEC**”) staff from the Chairman’s Office, the Division of Investment Management (“**IM**”), the Division of Trading and Markets (“**TM**”), the Division of Corporation Finance (“**CF**”), and the Division of Risk, Strategy and Financial Innovation (“**RF**”).

The representatives of Occupy the SEC that were present at the meeting were: Alexis Goldstein, Akshat Tewary, Caitlin Kline and Eric Taylor.

Jennifer McHugh from the Chairman’s Office participated in the meeting.

The following members of IM staff participated in the meeting: Daniel Kahl, Tram Nguyen, Michael Spratt and Parisa Haghshenas.

The following members of TM staff participated in the meeting: Catherine McGuire, Gregg Berman, David Bloom, Anthony Kelly, Haimera Workie, Amar Kuchinad, Linda Sundberg, Angela Moudy, and Thomas Eady.

The following members of CF staff participated in the meeting: David Beaning, Katherine Hsu, Raquel Fox and Chauncey Lane.

The following members of RF staff participated in the meeting: Adam Younce and Samantha Grunberg.

The topics of discussion were the restrictions on proprietary trading and hedge fund and private equity fund investments under Section 619 of the Dodd-Frank Act.



Occupy the SEC

<http://www.occupythesec.org>

MEMORANDUM

To: U.S. Securities and Exchange Commission
From: Occupy the SEC
Re: Congressional Intent Behind the Volcker Rule
Date: March 20, 2012

1. The term "proprietary trading", when used with respect to a banking entity or nonbank financial company supervised by the Board, means engaging as a principal for the trading account of the banking entity or nonbank financial company supervised by the Board in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, **any contract of sale of a commodity for future delivery**, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule as provided in subsection (b)(2), determine. (Statute)
2. The definition of proprietary trading in paragraph (4) covers a wide range of financial instruments, including securities, **commodities**, futures, options, derivatives, and **any similar financial instruments**. (Congressional Record)
3. The law provides **no statutory authority to exclude transactions including spot commodities or forward contract positions that are to be physically settled** from the Merkley-Levin Provisions, nor should they be excluded. (Merkley-Levin Comment Letter)
4. The Proposed Rule does not fulfill the law's promise. Instead, the Proposed Rule seems focused on minimizing its own potential impact. It engages in contortion that appear to be aimed at trying to restrict banks' trading without impacting the volume of banks' trading in the markets. This is not an objective of the Merkley-Levin Provisions. One key objective of the Merkley-Levin Provisions is to stop proprietary trading and relationships with private funds by our banks. That objective ***necessarily means less trading*** by them. And while stopping proprietary trading and private fund investments by banks may temporarily impact some markets we believe - and **Congress determined** - that the benefits of a safer financial system outweigh those potential impacts. (MLCL)
5. Section 13 also provides **no statutory authority for the proposed complete exclusion of repurchase and reverse repurchase agreements from the definition of "trading account"**... A blanket exclusion of these transactions from the reach of the Merkley-Levin Provisions is

particular problematic, since **repurchase and reverse-repurchase agreements can be structured to effect proprietary trades and engage in material conflicts of interest.** (MLCL)

6. Barring high risk strategies may be particularly critical when policing market-making-related and hedging activities, as well as trading otherwise permitted under subparagraph (d)(1)(A). In this context, however, **it is irrelevant whether or not a firm provides market liquidity:** high-risk assets and high-risk trading strategies are never permitted. (Congressional Record)

7. As a general rule, firms taking advantage of this provision should maintain only small seed funds, **likely to be \$5 to \$10 million or less. Large funds** or funds that are not effectively marketed to investors **would be evasions of the restrictions of this section.** (CR)

8. The Proposed Rule fails to address the issue of "seed funds," despite clear statements of Congressional Intent that it do so... For example, the Final Rule should establish a clear limit on the amount of seed funds that a bank may provide to a new fund. We understand that **a maximum dollar amount such as \$10 million would be sufficient** for a fund to build a track record to attract other investors. In addition, the Final Rule should prohibit any investment that would exceed the statutory three percent limit one year after a new fund is established... The statutory provisions relating to timing and investment **were heavily negotiated, and any exemption or extension would be contrary to the plain language of the statute.** (MLCL)

9. One major weakness in this part of the Proposed Rule is allowing hedging on a portfolio basis. This contrasts sharply to professional traders who have told us that hedges are, by far, most effectively utilized as actual hedges when matched on a position by position basis, and not on a portfolio basis.

As many have noted, **banks could easily use portfolio-based hedging to mask proprietary trading...** The reason why forty-two words were added between our first bill's introduction and the final language was to make sure that every single position taken as a hedge would be tied to a "specific risk" arising from another "specific" position, whether that position is an individual holding a certain asset or an aggregation of the position of that particular asset. The use of the term "aggregate" position is to give comfort that the firms do not have to hedge on a trade-by-trade basis, but only a position-by-position basis. (MLCL)

10. Another problem with the Proposed Rule's "risk mitigating hedging" language is that it **creates an indefensible loophole to proposed restrictions on compensation arrangements for hedges...** Thus peculiar so called "hedge" could lead to further evasion of the fund investment restrictions, as firms could readily exceed their 3%-3% statutory limits... The proposed provision should be stricken from the rule. (MLCL)

11. If a bank is making profit through the appreciation or depreciation of an asset, then it's engaged in proprietary trading. Focusing on the underlying economics means the Proposed Rule **can eliminate many of the newly proposed exemptions and loopholes, including the blanket exemption for repurchase agreements, allowance of hedging on a portfolio basis, or the proposal to allow firms to "hedge" how much they may have to compensate their fund managers by investing in the fund the manager oversees.** (MLCL)

12. The proposed rule proposes multiple broad exclusions from the "trading account" that have **no basis in law**, including for **repurchase agreements, reverse repurchase agreements, spot commodities, currencies, and general liquidity management**. These exclusions should be eliminated, as should several other unnecessary exemptions, such as proposed **hedging exemptions related to bank investments in private funds**. (MLCL)

**SEC Strategic Plan
Fiscal Years 2010 - 2015**

Strategic Goal 1: Foster and enforce compliance with federal securities laws

Outcome 1.2: "The SEC promptly detects violations of federal securities laws"

Outcome 1.3: "The SEC persecutes violations of the Federal Securities Laws and holds violators accountable"

Strategic Goal 2: Establish an effective regulatory environment

Outcome 2.3: "The SEC adopts and administers rules and regulations that enable market participants to understand *clearly* their obligations under the securities laws" (emphasis added)